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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 2005

OVERVIEW

- In the first quarter of 2005 real gross domestic product (GDP) grew 2.3% following a 2.1% increase in the fourth quarter of 2004.
- Final domestic demand remained strong, rising 5.8% following a gain of 4.3% in the fourth quarter of 2004. Stronger consumer spending and business investment in plant and equipment led the way. However, businesses accumulated $15.8 billion in inventories, a decrease from the $22.6-billion inventory investment in the fourth quarter.
- Increased domestic demand was partly met through a 10.6% jump in real imports. Real exports rose 5.9% following declines in the previous two quarters.
- The current account registered its 23rd consecutive quarterly surplus despite a drop of $5.1 billion to $16.0 billion or 1.2% of nominal GDP.
- Since the end of 2003 the Canadian economy has created over 280,000 net new jobs, all of them full-time. The unemployment rate dipped to 6.8% in April, near its lowest level in the period since 1976.

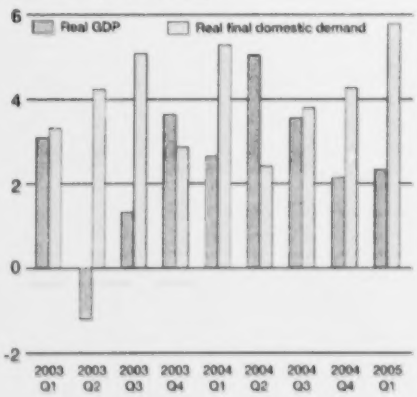
Real GDP grows 2.3%

Real GDP rose 2.3% in the first quarter following a 2.1% gain in the fourth. Final domestic demand grew a robust 5.8%, up from 4.3% in the previous quarter (Chart 1).

Consumer spending growth rises

Real consumer expenditure grew 6.3% in the first quarter, up from the fourth-quarter pace of 3.8%. Consumption of durables, non-durables, semi-durables and services all showed stronger growth than in the previous quarter. Spending was particularly robust on furniture and appliances.

Chart 1
Growth in real GDP and real final domestic demand
per cent (annual rate)



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is end of day, May 31, 2005.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2003	2004	2004:Q3	2004:Q4	2005:Q1		Most recent
Real gross domestic product	2.0	2.9	3.5	2.1	2.3		–
Final domestic demand	3.6	3.9	3.8	4.3	5.8		–
Government expenditure							–
Goods and services	2.9	2.7	2.0	2.1	3.2		–
Gross fixed capital	4.5	4.9	-0.3	3.6	5.0		–
Consumer expenditure	3.1	3.4	3.5	3.8	6.3		–
Residential investment	6.2	8.3	7.1	5.2	-1.7		–
Business fixed investment	[illegible]	6.1	7.4	9.9	12.7		–
Non-residential construction	[illegible]	0.8	1.7	0.9	7.5		–
Machinery and equipment	6.4	9.8	11.4	16.5	16.3		–
Business inventory investment ($ billion)	11.1	11.5	17.3	22.6	15.8		–
Exports	-2.1	5.0	-2.8	-3.1	5.9		–
Imports	4.1	8.1	12.4	8.3	10.6		–
Current account balance							
(nominal $ billion)	18.4	28.8	28.7	21.1	16.0		–
(percentage of GDP)	1.5	2.2	2.2	1.6	1.2		–
Nominal personal income	3.4	4.3	3.8	4.5	2.6		–
Nominal personal disposable income	3.7	3.9	2.2	3.5	1.2		–
Real personal disposable income	2.1	2.5	1.4	2.1	-0.3		–
Profits before taxes	8.7	18.7	3.7	6.1	15.6		–
Costs and prices (%, y/y)							
GDP price deflator	3.3	3.0	3.4	3.5	2.9		–
Consumer price index	2.8	1.9	2.0	2.3	2.1	2.4	Apr-2005
CPI excluding eight most volatile items	2.2	1.5	1.7	1.6	1.8	1.7	Apr-2005
Unit labour costs	2.2	1.6	1.3	1.3	1.1		
Wage settlements (total)	2.6	1.7	1.4	2.1	2.5	2.6	Mar-2005
Labour market							
Unemployment rate (%)	7.6	7.2	7.1	7.1	7.0	6.8	Apr-2005
Employment growth	2.3	1.8	1.3	1.7	0.6	2.2	Apr-2005
Financial markets (average)							
Exchange rate (cents U.S.)	71.6	77.0	76.5	81.9	81.5	79.61	31-May-05
Prime interest rate (%)	4.7	4.0	3.8	4.3	4.3	4.25	31-May-05

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Skills Development Canada.

Personal income registered a 2.6% gain in the first quarter following a 4.5% increase in the fourth. Labour income increased 3.7%, down from 4.4% in the previous quarter. Real personal disposable income dipped 0.3% following five consecutive gains. Per capita real personal disposable income decreased 0.8%, but stood 1.0% above its level of a year earlier. After saving 1.0% of disposable income in the fourth quarter, consumers spent more than their disposable income in the first quarter, the first time the savings rate has been negative.

Residential investment eases back

Residential investment decreased 1.7% in the first quarter. While low interest rates continued to support housing activity at a high level, housing starts dipped, lowering new construction activity by 6.3% after a fourth-quarter rise of 6.4%. Renovations rose 1.8% following two consecutive quarters of double-digit increases. Housing resale activity produced a 7.2% gain in real estate transfer costs following a 17.9% drop in the fourth quarter.

Business fixed investment strengthens

Business spending on plant and equipment grew 12.7% in the first quarter, the ninth consecutive increase. Investment in machinery and equipment jumped 16.3%, the third consecutive double-digit gain (Chart 2). Investment spending on computers and other office equipment soared 51.3% while it jumped nearly 35% in non-automotive transportation equipment. Investment in industrial machinery and motor vehicles also increased sharply.

Non-residential construction increased 7.5% after a weak fourth-quarter gain. Unlike the five previous quarters, both building construction, such as office towers and shopping malls, and engineering projects contributed positively to growth.

Business inventory accumulation slows

Businesses increased inventories by $15.8 billion in the first quarter following an accumulation of $22.6 billion in the fourth quarter. The first-quarter slowdown was concentrated in wholesale industries, especially in durable goods such as motor vehicles. The inventory-to-sales ratio remained well below its historical average.

Exports rise

Real exports increased 5.9% in the first quarter following declines in the previous two quarters. Within goods, gains were most notable in energy products and machinery and equipment, especially information and communications technology equipment given strong U.S. growth in investment in telecommunications equipment, computers and software. Automotive exports declined as vehicle sales, especially those of light trucks, plunged in the United States. Increased prices for gasoline have harmed SUV sales. Exports of services rose 5.5%.

Imports outgrow exports

Real imports registered a sixth consecutive gain, climbing 10.6%. The increase was broadly based. Investment growth boosted machinery and equipment imports by 11.1%, the sixth consecutive double-digit increase. Imports of automotive products rose with domestic vehicle sales, but at a more muted 4.6% as declining automotive exports negatively affected imported inputs. Other consumer goods imports actually declined. Imports of services increased 7.9% as spending on foreign travel climbed 17.8%.

Current account surplus narrows

In the first quarter, the current account registered its 23rd consecutive surplus, in contrast with deficits throughout most of the 1980s and 1990s. The surplus, however, fell to $16.0 billion or 1.2% of nominal GDP from $21.1 billion in the previous quarter (Chart 3). With real imports rising more than real exports and export prices declining, the goods trade surplus dropped $5.0 billion. Increased spending on foreign travel worsened the trade surplus by another $1 billion.

Chart 2
Growth in real machinery and equipment investment

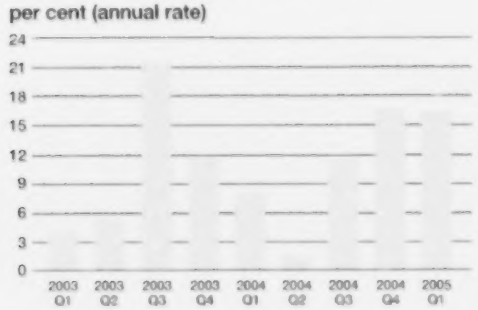
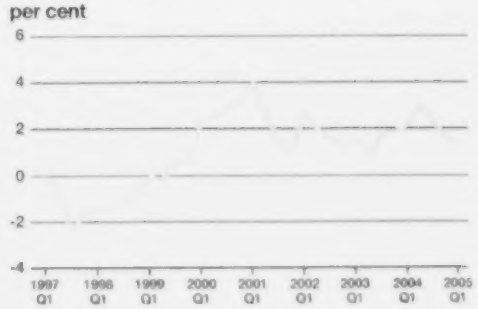


Chart 3
Current account as a percentage of nominal GDP

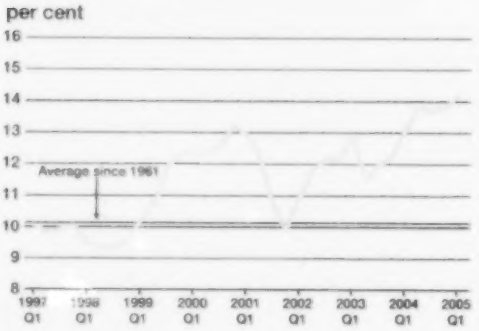


A sharp drop in dividend payments to non-residents, however, contributed to a $1.6-billion improvement in the investment income deficit, moderating the deterioration in the current account surplus.

Corporate profits grow more quickly

Corporate profits rose 15.6% in the first quarter, more than double the fourth-quarter pace of 6.1%. A strong upward trend in profits has raised their share of GDP to a record 14.1%, well above the 10.1% historical average since 1961 (Chart 4). Among non-financial enterprises, oil and gas producers and other mining companies reported strong gains, benefiting from high commodity prices. Among financial enterprises, chartered banks' profits increased sharply.

Chart 4
Profits before taxes as a share of nominal GDP



Consumer price inflation remains low

The GDP deflator, a comprehensive measure of prices, rose 1.5% in the first quarter, somewhat slower than in the previous quarter, to stand at a level 2.9% higher than a year earlier.

Year-over-year consumer price inflation stood at 2.4% in April, up from 2.3% in March as prices for gasoline, fuel oil and vegetables increased. At 1.7% in April, core CPI inflation, which excludes the eight most volatile items, sat below the 2% mid-point of the 1% to 3% target band.

Unemployment rate approaches its low

Employment grew 0.6% in the first quarter, and another 29,000 jobs were added in April. Since the end of 2003 the Canadian economy has created 280,900 net new jobs, all of them full-time. The participation rate sat at 67.2% in April, down from March and from its record high of 67.7% first set in late 2003 and matched several times since. The unemployment rate dipped to 6.8%, slightly above the low in mid-2000 and early 1976.

Hourly labour productivity growth slowed to 1.1% from over 4% in the fourth quarter. Labour costs per unit of output rose a little over 1% in the first quarter to stand a little over 1% higher than a year earlier.

Bank of Canada holds policy rate steady

On May 25, as in April, March, January and December, the Bank of Canada maintained its key policy rate—the target for the overnight rate—at 2.50 per cent. The Bank stated that "the Canadian economy is expected to move back to its production capacity in the second half of 2006, with core inflation projected to return to 2 per cent around the end of next year."

With the U.S. Federal Reserve having raised its target rate 25 basis points seven times from August 2004 to May 2005, U.S. interest rates are higher at all maturities up to 10 years than those in Canada.

Since closing at 85.04 cents U.S. on November 26, 2004, its highest value in nearly 13 years, the Canadian dollar has eased back to close at 79.61 cents U.S. on May 31, 2005.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Steven James at (613) 992-4321. Also available on the Internet at www.fin.gc.ca
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